BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

LeRoy Koppendrayer	Chair
Marshall Johnson	Commissioner
Ken Nickolai	Commissioner
Thomas Pugh	Commissioner
Phyllis A. Reha	Commissioner

In the Matter of a Filing by Aquila, Inc. to Establish a Large Volume Daily Balancing Service

ISSUE DATE: September 9, 2005

DOCKET NO. G-007,011/M-03-276

ORDER EXTENDING AQUILA'S LARGE VOLUME BALANCING SERVICE WITH MODIFICATIONS

PROCEDURAL HISTORY

On March 21, 2003, the Commission directed Aquila, Inc. (Aquila) to offer a regulated balancing service to its large volume customers, and to work with the Minnesota Department of Commerce (the Department) and potential customers in developing the service.[1]

On June 30, 2003, Aquila filed its proposed Large Volume Balancing Service (LVBS) and proposed a technical conference to address party concerns. The Department convened the conference on July 30, and Aquila amended its proposal on August 15. On February 27, 2004, the Commission approved a modified version of Aquila's proposal as a pilot program and directed Aquila to report on its experience with the service by May 31, 2005.[2] Aquila began offering its LVBS on April 1, 2004.

On May 27, 2005, Aquila reported that no customers had taken the service. Aquila proposed to terminate the service or to extend the service for an additional year at a lower rate.

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[1] *In the Matter of the Complaint of Pro-Corn, LLC Against Aquila, Inc. (Formerly UtiliCorp United Inc.),* Docket No. G-007,011/C-02-1602, ORDER APPROVING WITHDRAWAL OF COMPLAINT AND OPENING TWO NEW DOCKETS; see also ORDER DENYING RECONSIDERATION (May 30, 2003).

[2] Current docket, ORDER APPROVING AQUILA'S LARGE VOLUME BALANCING SERVICE WITH MODIFICATIONS.

By July 7, 2005, the Commission had received comments from CenterPoint Energy Services, Inc. (CESI); the Department; U.S. Energy Services, Inc. (U.S. Energy); and collectively from Hibbing Taconite Joint Venture, Ispat Inland Mining Company, Northshore Mining Company and United States Steel Corporation (the Large Power Intervenors).

On July 7 and 18, 2005, Aquila filed reply comments.

This matter came before the Commission on August 18, 2005. During the hearing Aquila indicated that, barring the sale of the utility's Minnesota properties, Aquila planned to file a general rate case to seek additional revenues.

FINDINGS AND CONCLUSIONS

I. Background

Aquila models its LVBS on the System Management Service (SMS) it receives from the Northern Natural Gas Company (Northern), as discussed below.

A. Relationship between Aquila and Pipelines

The gas Aquila provides to its customers is delivered to Aquila's system by interstate pipelines such as the one operated by Northern. For operational purposes, Northern requires customers such as Aquila to state how much gas the customer will ship each day. Generally when the amount the customer takes differs from the amount the customer said it would ship by more than 5% on a given day, Northern imposes a scheduling penalty on the customer. Also, once a month Northern requires each customer to buy gas from or sell gas to Northern to reconcile the amount of gas added to Northern's system on the customer's behalf with the amount of gas taken out at scheduled delivery points; to encourage customers to remain in balance, these monthly "cash-out" terms are disadvantageous to customers.

Aquila pays Northern to reserve space on the pipeline, thereby ensuring that the pipeline will give a higher priority to shipping Aquila's gas than to shipping the gas of parties that do not have reservations. By reserving "firm" capacity, Aquila also qualifies to purchase System Management Service (SMS) from Northern. SMS permits Aquila to exceed the 5% imbalance without incurring a penalty; the more SMS Aquila buys, the further out of balance Aquila can be before penalties accrue.

B. Relationship between Aquila and Customers

Aquila provides a variety of services to its customers, and the cost of those services is reflected in Aquila's prices. For a general service customer, the price includes the cost of buying the gas, the cost of buying capacity on the pipeline and transporting the gas from the gas well to a point where the pipeline connects to Aquila's plant (the "town border station" or "TBS"), and the cost of distributing the gas on Aquila's distribution network from the TBS to the customer's premises.

But some customers prefer to purchase their own supply of gas and make their own arrangements with the pipeline to deliver that gas to the TBS (or, frequently, hire energy services companies to make these arrangements on the customers' behalf). For these customers, Aquila offers a service to transport the gas from the TBS to the customer's premises.

When the amount of gas that one of Aquila's transportation customers schedules differs from the amount of gas that the customer actually uses, the pipeline may impose an imbalance penalty on Aquila and require a monthly cash-out. Aquila may pass through the cost of these penalties to the transportation customer, and may impose its own imbalance penalties.

C. Aquila's Large Volume Balancing Service

Transportation customers seek a service to help them avoid imbalance penalties, just as Northern's SMS helps Aquila avoid imbalance penalties. At the Commission's direction, Aquila offers such a service to its large volume customers, called the Large Volume Balancing Service. The price of the service is designed to cover 1) the value of SMS used in providing the service, 2) revenues Aquila might have to forgo in order to retain sufficient firm capacity to qualify to purchase the necessary amount of SMS, and 3) the risk that transportation customers will exploit the service to compel Aquila to "cash out" gas on terms unfavorable to Aquila. The current price is $5.47 per unit of reservation demand.

During the technical conference convened to develop Aquila's LVBS pilot program, some parties expressed concern about the affect of the LVBS on Aquila and, indirectly, on customers who were not taking the service.[3] They argued that LVBS relies on SMS, and that the amount of SMS Northern will provide to Aquila is linked to the amount of firm transportation capacity that Aquila reserves. If the demand for LVBS grew large enough, they reasoned, Aquila might need to purchase more firm capacity in order to secure enough SMS. But while contracts for firm capacity typically last four years, nothing in Aquila's LVBS requires a customer to continue taking the service for four years. Consequently, a customer might subscribe for LVBS – thereby causing Aquila to purchase four years of additional capacity and SMS – and then the customer might drop the service – thereby leaving Aquila with added, uncompensated costs.

Aquila addressed these stranded cost concerns by proposing to limit the size of its pilot program to a level that would not require Aquila to buy any additional firm capacity and SMS. But Aquila acknowledged that it would need to find a different solution in the future if Aquila were to provide LVBS more broadly.

In approving Aquila's LVBS, the Commission directed Aquila to report back on its experience with providing the service. Specifically, the Commission directed Aquila to make a recommendation for dealing with the stranded cost issue, and to report on –

[3] See generally Aquila supplemental comments (August 15, 2003).

- the number of customers that are participating in the pilot program,
- the amount of LVBS for which each customer subscribes,
- the cost associated with implementing the pilot program, and
- the revenues associated with the pilot program.

II. Aquila's Proposal

Given the lack of interest in the LVBS, Aquila proposes to stop offering it. Aquila argues that other, non-regulated entities provide a comparable service for Aquila's system.

Alternatively, Aquila proposes extending the program for an additional year, re-priced to reflect a net reduction in the cost of providing the service. This would reduce the price from $5.47 per unit of reservation demand to $4.35. But Aquila opposes reducing the price of the service below its cost, even if the $4.35 price does not attract any customers.

III. Parties' Positions and Aquila's Replies

The Large Power Intervenors support Aquila's proposal to end the pilot program. These intervenors do not qualify for Aquila's LVBS, but retain an interest because of their concern that the program exposes Aquila to financial risks that may affect the rest of Aquila's ratepayers.

Given that the cost of providing LVBS has declined, the Department favors testing customer demand by adopting Aquila's proposal to extend the LVBS program for another year at the lower price. The Department also recommends that, by next May, Aquila address the same issues the Commission directed Aquila to address in its May 2005 filing.

CESI and U.S. Energy, both energy services companies, argue that Aquila's LVBS has failed to attract customers because the price is too high – as much as 270% higher than similar services offered by utilities such as Northern States Power Company d/b/a Xcel Energy (Xcel) and CenterPoint Energy Minnesota Gas (CenterPoint). In addition, U.S. Energy objects to Aquila's policy of limiting the amount of balancing service that a customer may order. U.S. Energy asks that the service be extended on terms comparable to the terms offered by other utilities; CESI recommends a price of $2.44 per unit of reservation demand.

Aquila defends the terms of its LVBS offering, noting that they were developed through a collaborative process involving potential customers and the Department, and approved by the Commission. Where changed circumstances warrant a change in price, Aquila has proposed to make that change, but Aquila continues to oppose any proposal that would result in offering LVBS below its risk-adjusted cost.

Aquila notes that no party has suggested that it would take Aquila's LVBS even if offered at the new price of $4.35 per unit of reservation demand. To the contrary, Aquila notes CESI's assertion that this price will "all but insure that no marketers or customers will participate." Given these circumstances, Aquila renews its request to terminate the program.

IV. Commission Action

In its March 21, 2003 Order, the Commission concluded that large volume transportation customers are seeking balancing service and that the public interest would be served if Aquila would offer these customers the option of securing balancing service, provided that the service's price covered its costs. But no party has yet subscribed to Aquila's LVBS. The benefit to the public is placed in doubt if the price is so high that no one will buy it.

Aquila concludes that the service is providing no benefits and therefore should be discontinued. CESI and U.S. Energy conclude that the service's price is too high and should be reduced. And the Large Power Intervenors conclude that the service should be discontinued because its risk-adjusted cost already exceeds its price. Collectively, these parties raise two questions: Is the formula for setting the LVBS's price appropriate? And if so, does the risk-adjusted cost of the service exceed its benefit, rendering the service superfluous?

As Aquila and the Department note, the formula for setting LVBS's price arose through a joint process involving Aquila, the Department and potential customers. Nothing in the record to date persuades the Commission to set that work aside. The Commission will therefore decline the request of CESI, the Large Power Intervenors and U.S. Energy to change the pricing formula at this time. However, the Commission will direct Aquila to study the balancing services offered by CenterPoint and Xcel and, as part of Aquila's impending rate case filing, to file an alternative proposal based on their services.

Aquila argues that if the formula produces a price that is so high that no one will buy it then there is little point in offering the service. But as the Department argues, and Aquila acknowledges, the way to determine whether a price is higher than customers will pay is in the market. Given that the cost of providing LVBS has declined, the Commission cannot know whether the resulting lower price would attract customers unless Aquila offers the service at the new price.

Consequently, the Commission will adopt the Department's recommendation and accept Aquila's offer to continue the LVBS pilot program, but at a price reflecting its new, lower cost. Given that Aquila anticipates filing a rate case which will trigger a re-evaluation of all of Aquila's rates and services, the Commission will direct Aquila to maintain its LVBS program through the end of that case. Aquila may propose changes to the service at that time.

The Commission will also adopt the Department's recommendation to direct Aquila, when it makes its rate case filing, to report the information it included in its May 2005 filing. Specifically, Aquila should report on the number of participants, the amount of service taken by each participant, and the pilot program's cost and revenues. Aquila should also discuss the stranded cost issue and how it should be addressed in the future. This information, combined with Aquila's analysis of other utilities' balancing services, will provide the Commission with a foundation for evaluating future proposed changes to Aquila's LVBS.

ORDER

1. The Large Volume Daily Balancing Service pilot program of Aquila, Inc., is extended until the end of Aquila's next rate case, with a new price of $4.35 per unit of reservation demand. Aquila shall file conforming tariff sheets within ten days of this Order.

2. In its next rate case filing, Aquila shall do the following:

   A. Address the stranded cost issue, together with possible alternative solutions.

   B. Report on –

      - the number of customers that are participating in the pilot program,
      - the amount of LVBS for which each customer subscribes,
      - the cost associated with implementing the pilot program, and
      - the revenues associated with the pilot program.

   C. Include an alternative proposal for a balancing service similar to the balancing service offered by CenterPoint Energy Minnesota Gas and Northern States Power Company d/b/a Xcel Energy.

3. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

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